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1

MEMORANDUM FOR EXECUTIVE APPROPRIATIONS COMMITTEE

FROM: Thomas Young, Staff Economist
DATE: July 17, 2018
SUBJECT: Federal Tax Reform Corporate Tax Changes

Federal tax reform is expected to impact State Corporate Tax collections due to a variety of changes detailed below. We estimate the sum of those changes for fiscal year 2019 could be \$19 million in additional ongoing Education Fund revenue and \$36 million in additional one-time Education Fund revenue if Utah adopts the federal tax changes. Depending upon the policy decisions you make, the state could see no increased revenue and potentially have to refund some FY 2019 payments already made.

Working with the Tax Commission and Governor's Office of Management and Budget, we've developed the following consensus estimates for corporate tax components contained in federal tax reform assuming Utah adopts the federal changes.

Repatriation (one-time).....\$36 million

Without a forced repatriation rule, Congress' adoption of a territorial system would allow non-US subsidiaries to pay dividends to their US parent corporations, from hundreds of billions of dollars of earnings built up offshore before 2018, and fully escape US tax on those earnings. Congress instead opted to impose a one-time US tax on those earnings, at rates far lower than a US parent would have paid before the Act.

Global Intangible Low Taxed Income (GILTI)\$12 million

This provision is meant to discourage the location of high-value activities outside the US. It functions as a mandatory annual inclusion of global intangible low taxed income (GILTI) determined on an aggregate basis for all controlled foreign corporations owned by the same US shareholder, with partial credits for foreign taxes properly attributable to the GILTI amount. The GILTI inclusion effectively taxes foreign earnings in excess of a 10% rate of return on fixed assets at a reduced rate by providing a 50% deduction initially (subject to certain limitations), reduced to 37.5% for tax years beginning after 2025. At a 21% federal corporate tax rate, the deduction results in effective rates of 10.5% and 13.125% respectively.

Foreign Derived Intangible Income (FDII).....(\$15 million)

This provision is generally designed to encourage locating intangible assets in the US by providing a lower effective tax rate on high-returns related to foreign sales. Returns in excess of 10% of fixed assets form the basis of the calculation. This is achieved by providing domestic corporations a deduction against foreign-derived intangible income (subject to certain limitations) of 37.5% initially, reduced to 21.875% for tax years beginning after 2025. At a 21% federal corporate tax rate, the deduction results in effective rates of 13.125% and 16.40625% respectively.

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Net operating losses (NOL)\$6 million

Limits NOLs to 80% of taxable income for losses arising in tax years starting after 2017. Generally, repeals carryback provisions Allows NOLs to be carried forward indefinitely, subject to interest rate adjustment.

Interest Deduction\$15 million

Limits the deductibility of net interest expense to 30% of earnings before interest, taxes, depreciation, and amortization (EBITDA) for four years, and 30% of earnings before interest and taxes (EBIT) thereafter.

FDIC Fees\$1 million

Federal tax reform disallowed certain large banks from deducting Federal Deposit Insurance Corporation premiums and the computations for life insurance reserves. If no further action is taken, Utah will see additional state revenue due to the federal disallowance.

Capital Contribution.....\$0.2 million

When a governmental entity, for economic development, contributed capital to a corporation through a grant or incentive, this was not taxable income. Under tax reform, this is now taxable income.

There exists a great deal of uncertainty in these estimates due to lack of observed data. Further, some of this revenue might already be included in existing estimates and collections. We recommend that you continue the current course of waiting to see what happens with actual collections before committing these revenues to spending or tax changes.